



MEETING OF THE PENSION FUND PANEL

6 DECEMBER 2019

REPORT OF THE SERVICE DIRECTOR - FINANCE

1. Northumberland County Council Pension Fund: 2018/19 Annual Report and Accounts and external audit

Purpose of the report

This report updates the Panel on the finalisation of the Northumberland County Council Pension Fund (NCCPF) Annual Report and Accounts for the year to 31 March 2019, and provides the external auditor's updated "***Audit Results Report***".

Recommendation

The Panel is requested to accept the report.

Key issues

- 1.1 The NCCPF annual accounts form part of the NCC annual Financial Statements, reflecting the legal status of the Fund as part of NCC. The LGPS Regulations also require a **separate** Pension Fund Annual Report and Accounts to be prepared and published, so the Fund accounts appear in both documents.
- 1.2 Approval of the 2018/19 Financial Statement was expected at NCC's Audit Committee meeting on 24 July 2019, but it was deferred due to ongoing external audit investigations which prevented the auditors from issuing the Audit Opinion.
- 1.3 The *draft* NCCPF Annual Report and Accounts for 2018/19 was reported to the Pension Fund Panel in June 2019 and prepared without making reference to merger. Since then, formal decisions made by the Cabinet and South Tyneside Council together with Government's support for merger has necessitated the addition of a note to the accounts to explain the impact, for NCCPF, of potential merger. The changes to the draft accounts are detailed in **Appendix 1**.
- 1.4 The original draft 2018/19 Audit Results Report prepared by Ernst & Young LLP (EY) was reported to the Pension Fund Panel in September 2019. It was updated in November 2019 and is **enclosed** with these papers. It will also be reported to the Audit Committee on 27 November 2019 when, it is expected, the Financial Statements will be signed and finalised. Once signed, the final 2018/19 NCCPF Annual Report and Accounts will be published on NCC's website to meet the statutory deadline of 1 December 2019.
- 1.5 At the date of finalising this report, EY had not yet completed its assessment of the impact of potential merger on the Audit Opinion, so a verbal update will be provided at this meeting.

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2. Action Plan 2019

Purpose of the report

This report provides NCCPF's Action Plan 2019 (attached as **Appendix 2**) to the Panel. The Plan was finalised in October 2019 under a delegation.

Recommendation

The Panel is requested to accept the report.

Key issues

- 2.1 At the 23 February 2018 meeting of the Pension Fund Panel, members approved the Action Plan 2018 for NCCPF. The annual monitoring against the 2018 Plan was brought to the 22 February 2019 meeting of the Panel. All items in the 2018 Plan classed as essential and most items classed as desirable were achieved during 2018/19.
- 2.2 At the February 2019 meeting, the Panel noted that the Action Plan 2019 had not yet been formulated because of the uncertainty, at that stage, around whether or not merger of NCCPF and TWPF would be pursued. As the annual Action Plan should be agreed as soon as possible, a delegation was obtained for the Action Plan 2019 to be finalised by the Service Director – Finance, in consultation with the Chair and Vice Chair of the Panel, once merger plans were sufficiently advanced.
- 2.3 Key decisions on merger have now been made, including the political steer given by NCC's Cabinet on 8 October 2019. As work on merger progresses, the Panel's oversight of this process will take precedence over the other Panel business. In accountant's terminology, merger is a "*machinery of government change*" meaning a transfer of functions from one part of the public sector to another as a going concern. Over the next few Panel meetings, the Panel's focus will be to ensure that the transfer of functions from NCC to South Tyneside Council is carried out as efficiently as possible.
- 2.4 The Action Plan 2019, attached as Appendix 2, was finalised in October under a delegation and taken to NCC's LGPS Local Pension Board meeting on 18 October 2019, for information. It has been published on the NCCPF website.

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3. Scheme Advisory Board's review of LGPS governance: Phase II

Purpose of the report

This report provides information about Phase II of the Scheme Advisory Board's review of LGPS governance, which makes recommendations for changes to the governance regime for the LGPS in England and Wales.

Recommendation

The Panel is requested to accept the report.

Key issues

- 3.1 In October 2018, the LGPS Scheme Advisory Board (SAB) launched the "**Good Governance Review**" to consider ways of raising standards of governance across the LGPS, ensuring conflicts of interest are managed effectively, and ensuring the LGPS remains appropriately resourced to deliver on its obligations.
- 3.2 With assistance from Hymans Robertson (HR), the SAB engaged with LGPS stakeholders to explore four governance options. HR issued its findings in "*Good Governance in the LGPS*" Phase I report, which was brought to the Panel in September 2019. The model with most support from respondents was **Option 2**: greater ring fencing of the LGPS within existing structures.
- 3.3 In November 2019, HR published its "*Good Governance in the LGPS*" Phase II report, which is **enclosed** with these papers. This includes recommendations to implement the proposed new framework. The recommendations are set out in paragraph 3.14 of this report, together with a synopsis of how NCCPF's current practices compare with the recommendations.
- 3.4 The key messages from the Phase II report are:
 - **statutory guidance** will be developed to set out the standards that LGPS funds must meet, including an *enhanced* governance compliance statement; and
 - oversight will come in the form of a **biennial "Independent Governance Review"** ("IGR") for every fund which will provide an expert arms-length assessment of its governance arrangements.
- 3.5 The recommendations lack detail so it is hard to fully assess the impact of implementation, but they do not appear to suggest any radical change will be required in governance processes already in place for NCCPF or for Tyne and Wear Pension Fund (TWPF). In any event, assuming a merger date of 1 April 2020, NCC is unlikely to be a LGPS administering authority by the time compliance with the new regime is required.

3. Scheme Advisory Board's review of LGPS governance: Phase II

BACKGROUND

Good Governance in the LPGS: Phase I

- 3.6 In October 2018, the LGPS Scheme Advisory Board (SAB) launched the “**Good Governance Review**”. Its purpose was to consider ways of:
- raising **standards** of governance across the LGPS;
 - ensuring **conflicts of interest** are identified and managed effectively; and
 - ensuring the Scheme remains **appropriately resourced** to deliver its statutory functions and meet regulatory obligations.
- 3.7 In January 2019, the SAB procured assistance from Hymans Robertson (HR) to engage with LGPS stakeholders to explore potential LGPS governance options. HR issued the Good Governance Review online **survey**, which closed on 31 May 2019. The survey included four outline LGPS governance models on which it sought views.
- 3.8 The findings of the survey were reported to the SAB in July 2019. HR’s “**Good Governance in the LGPS**” (Phase I) report was then published and reported to the September 2019 meeting of the Panel. The model for which there was most support from respondents was **Option 2**: greater ring fencing of the LGPS within existing structures.
- 3.9 HR made a number of recommendations for the SAB to consider. The recommendations can be summarised as taking an ‘**outcomes-based**’ approach to governance with **minimum standards** rather than prescribing a ‘one size fits all’ governance model for the LGPS.

SAB's working groups

- 3.10 The SAB agreed to take forward HR’s Phase I findings and conclusions to improve governance in the LGPS and asked HR to provide support for Phase II. Two working groups were established, one each to focus on:
- **Standards and Outcomes** to set out the outcomes and standards that the SAB wishes to see achieved by funds, and how these outcomes should be evidenced; and
 - **Compliance and Improvement** to focus on establishing the compliance regime that will require independent assessment of funds against the framework.

Good Governance in the LPGS: Phase II

- 3.11 On 15 November 2019, HR published its Phase II report, prepared by the working groups to the SAB on Good Governance in the LGPS. The Phase II report is **enclosed** with these papers.
- 3.12 The report includes implementation proposals, and the changes needed to the statutory governance guidance to implement the framework. The proposals are detailed in paragraph 3.14, below.

3.13 The key messages from the Phase II report are:

- It calls for **statutory guidance** to set out the standards that LGPS funds are expected to meet. Under the guidance funds would be required to publish an *enhanced* governance compliance statement each year to set out how they comply with governance responsibilities. This would allow each fund the flexibility to work within its own local environment to achieve the outcomes needed and enhance the existing governance compliance statement to make it a more comprehensive disclosure.
- Oversight will come in the form of a **biennial “Independent Governance Review”** (“IGR”) for every fund which will provide an expert arms-length assessment of its governance arrangements. There are also proposals to introduce the LGA peer review programme to the LGPS to further facilitate sharing of best practice.

3.14 Each recommendation made in the Phase II report is shown below, together with a commentary, where appropriate, on NCCPF’s position and how it compares with the recommendations set out.

Recommendations	NCCPF’s position
A1: MHCLG will produce statutory guidance to establish new governance requirements for funds to effectively implement the proposals below (“ <i>the Guidance</i> ”)	N/A
A2: Each administering authority must have a single named officer who is responsible for the delivery of all LGPS related activities for that fund (“ <i>the LGPS senior officer</i> ”)	NCC’s S151 Officer could fulfil this role
A3: Each administering authority must publish an annual governance compliance statement that sets out how they comply with the governance requirements for LGPS funds as set out in the Guidance. This statement must be signed by the LGPS senior officer and, where different, co-signed by the S151 officer.	NCCPF updates its Governance Compliance Statement annually
B1: Each fund must produce and publish a conflicts of interest policy which includes details of how actual, potential and perceived conflicts are addressed within the governance of the fund, including reference to key conflicts identified in the guidance.	NCCPF already has a comprehensive Conflicts Policy in place
B2: The Guidance should refer all those involved in the management of the LGPS, and in particular those on decision making committees, to the guide on statutory and fiduciary duty which will be produced by the SAB.	The Conflicts Policy will need to be amended to refer to the Guidance, once issued
C1: Each fund must produce and publish a policy on the representation of scheme members and non-administering authority employers on its committees, explaining its approach to representation and voting rights for each party.	NCCPF already has a Governance Policy Statement in place which covers this
D1: Introduce a requirement in the Guidance for key individuals within the LGPS, including LGPS officers and pensions committee members, to have the appropriate level of knowledge and understanding to carry out their duties effectively.	NCCPF already has appropriate training practices for key individuals

D2: Introduce a requirement for s151 officers to carry out LGPS relevant training as part of the CPD requirements to ensure good levels of knowledge and understanding.	NCC's S151 Officer may require specific CPD training
D3: Administering authorities must publish a policy setting out their approach to the delivery, assessment and recording of training plans to meet these requirements.	NCCPF already has a Training Policy in place
D4: CIPFA and other relevant professional bodies should be asked to produce appropriate guidance and training modules for s151 officers and to consider including LGPS training within their training qualification syllabus.	N/A
E1: Each administering authority must document key roles and responsibilities relating to its LGPS fund and publish a roles and responsibilities matrix setting out how key decisions are reached. The matrix should reflect the host authority's scheme of delegation and constitution and be consistent with role descriptions and business processes.	NCCPF will need to develop a roles and responsibilities matrix
E2: Each administering authority must publish an administration strategy.	NCCPF already has an Administration Strategy in place
E3: Each administering authority must report the fund's performance against an agreed set of indicators designed to measure standards of service.	NCCPF will need to develop reporting of performance once indicators are agreed
E4: Each administering authority must ensure their committee is included in the business planning process. Both the committee and LGPS senior officer must be satisfied with the resource and budget allocated to deliver the LGPS service over the next financial year.	NCCPF may need to make minor changes to its planning process
E5: Each administering authority must give proper consideration to the utilisation of pay and recruitment policies, including as appropriate market supplements, relevant to the needs of their pension function. Administering Authorities should not simply apply general council staffing policies such as recruitment freezes to the pensions function.	NCCPF may need to make minor changes to current practices
F1: Each administering authority must undergo a biennial Independent Governance Review and, if applicable, produce the required improvement plan to address any issues identified. IGR reports to be assessed by a SAB panel of experts.	IGR is yet to be developed
F2: LGA to consider establishing a peer review process for LGPS Funds.	N/A

Commentary on the Phase II recommendations

- 3.15 The recommendations lack some crucial detail, for example, E3 requires the SAB to develop ten to fifteen KPIs, and until the detail is developed it is not possible to state how much work will be involved for administering authorities to implement the recommendations.
- 3.16 Nevertheless, at first sight the recommendations do not appear to suggest any radical change to the governance processes in place for NCCPF or for Tyne and Wear Pension Fund (TWPF).

Next steps

- 3.17 The Phase II report sets out the next steps for the SAB and the Ministry of Housing Communities and Local Government (MHCLG) to implement the proposals. The next steps are:
 - MHCLG to draft the guidance (per recommendation A1);
 - SAB to establish the KPIs (per recommendation E3); and
 - SAB to establish the IGR provider framework (per recommendation F1).
- 3.18 Phase III of the project will include drafting both the KPIs and the instructions for revised statutory guidance on governance compliance statements. Proposals will be considered by the SAB at its meeting on 3 February 2020.
- 3.19 Comments have been invited on the Phase II report by HR, though it is not a formal consultation at this point. The formal consultation will follow once the new statutory guidance is drafted.

Implications of merger

- 3.20 It is likely that the steps outlined in paragraph 3.17 above will take several months to draft, issue and consult on, after which there will be a period of grace to give administering authorities sufficient time to comply with the new regime.
- 3.21 Therefore, assuming a merger date of 1 April 2020, NCC is unlikely to be a LGPS administering authority by the time compliance is required.
- 3.22 The equivalent analysis (yet to be carried out) to that set out in paragraph 3.14 above in respect of TWPF would give a broadly similar picture. The only significant differences are in relation to:
 - recommendation A2 as TWPF has a Head of Pensions who would be the named LGPS senior officer;
 - recommendation E5 as TWPF already produces its own budget independent of South Tyneside Council, and recruitment freeze policies have never been applied to pensions in the past; and
 - recommendation F1 as TWPF already voluntarily carries out an independent governance review carried out by its internal audit outsourcing partner, however until the SAB's IGR regime is developed, it is unclear what will be required.

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4. MHCLG statistical release 2018/19

Purpose of the report

This report provides information about the MHCLG statistical release on LGPS funds in England and Wales in 2018/19, and compares Northumberland County Council Pension Fund's information with that of other funds.

Recommendation

The Panel is requested to accept the report.

Key issues

- 4.1 The Ministry of Housing, Communities and Local Government (MHCLG) has analysed LGPS fund "SF3" information submitted by all **87** administering authorities in **England and Wales** for **2018/19**. MHCLG issued a statistical release in October 2019 which is attached as **Appendix 3** to this report. This is the third year that data from England and Wales has been combined.
- 4.2 The statistical release shows that compared with the prior year, in 2018/19 aggregate expenditure on LGPS benefits increased by 5.7%, income from employees' contributions increased by 2.8%, income from employers' contributions decreased by 24.7%, with a 2.7% increase in the number of contributors. The sizeable decrease in income from employer contributions was largely due to a number of employers opting to pay for three years' deficit contributions in a single upfront payment in the previous year.
- 4.3 Comparing this information with NCCPF's data shows that the number of NCCPF's active members (i.e. contributors) has increased by more than the average fund, with income from employee contributions subsequently increasing more at NCCPF than the average. The income from employer contributions in 2018/19 for NCCPF has increased from the prior year marginally, as expected, however this is in contrast to the story for the LGPS as a whole, which saw a large decrease in employer contributions for 2018/19. The decrease for LGPS as a whole is due to the large upfront pension deficit contribution payments made by a number of employers at other funds in the previous year, whereas NCCPF employers' deficit payments remained static between 2018/19 and prior year.

4. MHCLG statistical release 2018/19

BACKGROUND

- 4.4 All LGPS administering authorities in England and Wales, including Northumberland County Council, are required by the Ministry of Housing, Communities and Local Government (MHCLG) to complete form "SF3" each year, following completion and external audit of the pension fund annual reports.
- 4.5 Form SF3 is completed mainly from the information in the annual accounts, with some further detailed information required, for example, a breakdown of the employer contributions into the "primary" and "secondary" contributions where primary and secondary are terms defined in the LGPS Regulations.
- 4.6 MHCLG has aggregated and analysed the SF3s submitted by all **87** administering authorities in England and Wales for 2018/19 in a statistical release issued in October 2019. This is attached as **Appendix 3** to this report. It shows **aggregate amounts for all English and Welsh LGPS funds**. This is the third year that data from England and Wales has been combined.
- 4.7 The key points from the 2018/19 statistical release are:
- 4.7.1 Overall LGPS expenditure in 2018/19 was £12.7 billion, a like-for-like increase of 5.7% on the equivalent 2017/18 figure. LGPS expenditure on benefits in 2018/19 was £10.4 billion, an increase on the previous year of 6.0%.
 - 4.7.2 Overall income to the LGPS in 2018/19 was £15.1 billion, a decrease on 2017/18 (on a like-for-like basis) of 13.2%. Income from employees' and employers' contributions for the same period increased by 1.9% and decreased by 27.7% respectively, with the substantial decrease in employer contributions largely due to a number of employers opting to pay for three years' deficit contributions in a single upfront payment in the previous year.
 - 4.7.3 Income from investments increased by 0.7% in 2018/19 to £4.4 billion.
 - 4.7.4 The market value of the funds at the end of March 2019 was £287.2 billion. This represents an increase of 6.0% on March 2018.
 - 4.7.5 There were just under 2.0 million employees contributing to the LGPS at the end of March 2019, a 21,000 (or 1.1%) decrease over the figure for March 2018.
 - 4.7.6 The number of people leaving the LGPS in 2018/19 because of redundancy decreased by 18.8%, although a number of funds reported large restructuring exercises in the previous two years therefore this large reduction in 2018/19 is to be expected.
 - 4.7.7 The number of former employees entitled to deferred benefits rose to 2.2 million in 2018/19, an increase of 4.8% over 2017/18.
 - 4.7.8 The number of employers increased by 5.8% over 2017/18, largely as a consequence of academy formation.

- 4.8 NCCPF's increase in market value in 2018/19 of 4.2% is lower than the national average (6.0%) which reflects, the increasing maturity of NCCPF and the subsequent 'cash flow negative' position this creates, and the £26 million provision in the accounts as at 31 March 2019, to allow for an asset transfer from NCCPF to TWPF in relation to Northumberland College.
- 4.9 Over the last decade since austerity began, notwithstanding the increase in contributor numbers between 2012/13 and 2018/19, the position for the LGPS in England can be summarised: the trend has been for **LGPS workforces to shrink and funds to mature**. Auto-enrolment has *masked* that trend, but it is difficult to see the underlying trend truly changing in the next few years. The average contribution rate per employee has reduced over the period both nationally and for NCCPF, indicating an increase in the numbers of lower paid and/or part time staff in the Scheme, another consequence of auto-enrolment.

Comparing the Northumberland Fund with the other LGPS funds

- 4.10 Comparing Northumberland with the 87 funds in England and Wales, from the information shown in the statistical release:

		<u>all 87 administering authorities</u>	<u>NCC Pension Fund</u>
(a)	Expenditure on benefits comparing 18/19 with 17/18	increase of 6.0%	increase of 8.4%
(b)	Employees' contributions comparing 18/19 with 17/18	increase of 2.8%	increase of 4.4%
(c)	Employers' contributions comparing 18/19 with 17/18	decrease of 24.7%	increase of 3.1%
(d)	Total expenditure as a proportion of income in 18/19	84%	151% *
(e)	Total expenditure as a proportion of income in 17/18	73%	102% *
(f)	Income from investments comparing 18/19 with 17/18	increase of 0.7%	decrease 14.3%
(g)	Market value of funds comparing 31/3/19 with 31/3/18	increase of 6.0%	increase of 4.2%
(h)	Market value of funds comparing 31/3/19 with 31/3/15	increase of 34.2%	increase of 31.2%
(i)	Number of LGPS employees comparing 31/3/19 with 31/3/18	decrease of 1.0%	increase of 2.4%
(j)	Number of LGPS employers comparing 31/3/19 with 31/3/18	increase of 5.8%	decrease of 2.3%
(k)	Active membership as a proportion of total membership as at 31/3/2019	33.3%	34.6%
(l)	Active membership as a proportion of total membership as at 31/3/2018	34.6%	33.8%

* see explanation in paragraph 4.11 below.

The statistics are collated from the SF3 forms completed by LGPS funds each year and after removing the effect of mergers and large transfers during 2017/18 and 2018/19.

- 4.11 Items (d) and (e) in paragraph 4.10 appear to show that NCCPF is very much out of step with other funds. However, this is not the case, and these comparators are anomalies caused by NCCPF's investment management structure, particularly the large proportion of investments held in pooled vehicles where income is "rolled in" with the value of the units. Unlike other investments, these pooled vehicles do not pay income to the Fund, instead the income is reinvested so is reflected in the realised or unrealised gains on investments. NCCPF does not gain or lose as a result of this structure, but its income disclosed in its accounts appears low when compared with other funds'. The numbers are also distorted in 2018/19 due to the £26 million estimated asset transfer from NCCPF to TWPF in relation to Northumberland College, which was accounted for by NCCPF as a current liability.
- 4.12 NCCPF's number of LGPS employers (item (j) above) appears to be out of step with other funds, as it decreased by 2.3% compared to other funds' increase of 5.8%. This anomaly is largely because NCC has had fewer schools converting to academy status than has been the experience of other authorities, and also because transferred Northumberland College to TWPF prior to 31 March 2019.

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5. The Pensions Regulator's "cohort review"

Purpose of the report

This report provides information about the Pensions Regulator's (tPR) report "*Governance and administration risks in public service pensions schemes: an engagement report*" (known as **the cohort review**) which was published in September 2019.

Recommendation

The Panel is requested to accept the report.

Key issues

- 5.1 TPR published the "*Governance and administration risks in public service pensions schemes: an engagement report*" (known as **the cohort review**) in September 2019. The report, together with Hymans Robertson's sixty second summary of the findings, is attached as **Appendix 4**.
- 5.2 TPR's report shows the results of the cohort review, which began in Autumn 2018 when tPR engaged with ten LGPS funds to look closely at those funds' policies and practices.
- 5.3 The tPR cohort review was prompted by what tPR saw as a plateauing of LGPS fund administration performance and a lack of engagement by tPR and LGPS funds.
- 5.4 The overall conclusion from the cohort review was that tPR found the LGPS to be well run, with many instances of funds sharing best practice. However, some risks were identified by tPR including over-reliance on local authority (rather than fund) policies, key-person dependency, mixed performance of local pension boards, and data accuracy and cyber security issues.
- 5.5 NCC's LGPS Local Pension Board considered the cohort review at its meeting held in October 2019. The Board has requested that NCCPF's approach and practices be compared against tPR's 46 recommendations coming out of the cohort review, to ensure that any relevant lessons can be learned. The detailed comparison will be reported to the Board on 13 December 2019, and the Board will provide feedback to the Panel.

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6. Strategic Objectives for Investment Consultancy Services

Purpose of the report

This report provides an update on the introduction of strategic objectives for Mercer following the publication of the Competition and Markets Authority (CMA) Order in June 2019 in relation to the investment consultancy market.

Recommendation

The Panel is requested to accept the report.

Key issues

- 6.1 On 10 June 2019, the CMA published “*The Investment Consultancy and Fiduciary Management Market Investigation Order 2019*” (“**the Order**”), which places new obligations on service providers and pension schemes relating to fiduciary management (**FM**) and investment consultancy (**IC**) services. The Order applies to the LGPS and comes into effect on 10 December 2019.
- 6.2 For the LGPS, the “Relevant Sector Regulator” to implement the Order is MHCLG. However, Part 7 of the Order (i.e. the requirement to set objectives for IC) will apply until MHCLG has brought forward provisions in the LGPS on remedy 7. To be prudent, officers have assumed that the requirement to set strategic objectives for IC services will apply in the LGPS.
- 6.3 An IC service is the provision of advice, including advice:
 - on which investments are made;
 - the scheme manager is required by law to take;
 - on investment strategy; and
 - on manager selection.
- 6.4 In September 2019, the Panel delegated authority to the Service Director - Finance, in consultation with the Chair and Vice Chair of the Panel, to set the strategic objectives for Mercer, to ensure the 10 December implementation date could be met.
- 6.5 A tailored set of strategic objectives reflecting the circumstances of NCCPF have been developed using Mercer’s **model strategic objectives** for LGPS clients as a *starting point*. Changes were made by officers and agreed by Mercer particularly to add objectives in relation to merger and value for money.
- 6.6 The strategic objectives document for IC services provided to NCCPF by Mercer, agreed late in November 2019, is attached as **Appendix 5**.

6. Strategic Objectives for Investment Consultancy Services

BACKGROUND

CMA's investigations

- 6.7 In September 2017, the Panel received a report about the Financial Conduct Authority's (FCA's) reference to the Competition and Markets Authority (CMA) covering the FCA's concerns over conflicts of interests among investment advisers, and the potential for advisers encouraging clients to move from consultancy to more lucrative fiduciary management mandates. The FCA's concerns were over market concentration, notably for Aon, Mercer and Willis Towers Watson.

The IC and FM Order

- 6.8 In September 2019 the Panel received a report about the CMA's publication of "*The Investment Consultancy and Fiduciary Management Market Investigation Order 2019*" ("**the Order**"). The Order places new obligations on service providers and pension schemes relating to fiduciary management (**FM**) and investment consultancy (**IC**) services.
- 6.9 The expectation is that the "Relevant Sector Regulator" will implement the Order using terms that best fit within the applicable regulatory framework, so there will be an opportunity for interested parties to comment on the draft sector-specific provisions.
- 6.10 It is understood that currently, MHCLG is discussing next steps for LGPS funds with the CMA. Therefore, Part 7 of the Order (i.e. the requirement to set objectives for IC) will apply until MHCLG makes regulations and/or guidance which implements remedy 7 into the LGPS.
- 6.11 The Order comes into effect on **10 December 2019**.

Defining strategic objectives for investment consultancy services

- 6.12 Part 7 of the Order prohibits Pension Scheme Trustees (which it defines as including LGPS scheme managers) from entering into a contract or **continuing to obtain** IC services without setting strategic objectives for the IC provider.
- 6.13 Part 2 of the Order defines IC services as:

"Investment Consultancy Services means the provision to Pension Scheme Trustees of services where the provider advises the Pension Scheme Trustees in relation to one or more of the following:

- (a) Investments that may be made or retained by or on behalf of the Pension Scheme Trustees;
- (b) Any matters in respect of which the Pension Scheme Trustees are required by law to seek advice in relation to the preparation or revision of the statement of investment principles;
- (c) Strategic asset allocation;
- (d) Manager selection.

The reference to ‘advises’ means the provision of advice on the merits of the Pension Scheme Trustees taking or not taking a specific course of action and includes a recommendation or guidance to that effect.”

- 6.14 Strategic objectives are defined in the Order as:

“Strategic Objectives means the objectives for the Investment Consultancy Provider’s advice as applicable by reference to (a) to (d) of the definition of Investment Consultancy Services, in accordance with the Pension Scheme Trustees’ investment strategy.”

TPR’s consultation on guidance to implement the CMA Order

- 6.15 On 31 July 2019 the Pensions Regulator (tPR) published a consultation for a draft set of guides for schemes covering the obligations under the Order. These included a guide to “*Setting objectives for providers of investment consultancy services*”.

- 6.16 The draft guide sets out the legal obligations of schemes, provides examples of IC services and expands on setting objectives. It states:

“Adviser objectives can be quantitative and qualitative in their nature, for example these could be set in relation to investment performance delivered relative to the liabilities, adviser performance against service level agreements, communication skills, value for money and performance against specific tasks, such as asset transitions or investment manager selection exercises.”

- 6.17 Setting objectives for advisers is seen as an important part of an effective system of governance by the tPR. TPR expects that by putting objectives in place, trustees will be better positioned to assess the quality of the service they receive.

- 6.18 The CMA’s 2018 Investment Consultancy Market Investigation found that trustees had difficulty in monitoring the quality of investment consultancy services due to the limited information available to them. By increasing trustee engagement in the adviser appointment process and by setting objectives and monitoring performance against those objectives, tPR expects that trustees will achieve better outcomes for their schemes and better value for money. By monitoring the investment adviser’s performance against objectives trustees will be able to better identify and manage areas of poor performance and to consider switching to an alternate service provider, where appropriate.

- 6.19 The example case studies given by tPR take a balanced scorecard approach to scoring the activities undertaken by the IC provider, with examples of activities which trustees may wish to score, and qualitative as well as quantitative performance measures.

Impact on NCCPF

- 6.20 As a result of the Order, NCCPF is required to set strategic objectives for its investment consultant, Mercer, by 10 December 2019.

- 6.21 Mercer must then be assessed by the Panel against the objectives on a regular basis. For some objectives, an annual review may be appropriate, for others such as relating to strategic allocation advice, a longer term approach may be more appropriate.
- 6.22 Panel members are familiar with the balanced scorecard approach which the Fund applies currently to assessing IC services provided by Mercer. The current NCCPF scorecard is based upon the Pensions and Lifetime Savings Association template. Setting strategic objectives will provide a framework for enhancing this assessment process in the future, with some quantitative targets to evaluate performance against, in addition to the qualitative assessments already in use.
- 6.23 In September 2019 the Panel delegated authority to the Service Director - Finance, in consultation with the Chair and Vice Chair of the Panel, to set strategic objectives for Mercer before the CMA Order comes into effect on 10 December 2019.
- 6.24 Using Mercer's **model set of strategic objectives** for LGPS clients as a starting point, tailored strategic objectives reflecting the circumstances of NCCPF have been developed.
- 6.25 The agreed NCCPF objectives were informed by draft strategic objectives of other LGPS funds. In particular, additional objectives in relation to merger and value for money have been added to the original Mercer model. The investment strategy objective has also been expanded to include "*and also reflecting the Fund's cash flow position and minimising the risk of forced disinvestment.*"
- 6.26 The agreed strategic objectives document set by NCCPF in November 2019 for Mercer's investment consultancy services is attached as **Appendix 5**.

Next steps

- 6.27 A statement of compliance certified in accordance with the Order is required to be submitted to the CMA within 12 months of 10 December 2019, and annually thereafter.
- 6.28 The services provided by Mercer will be assessed annually by the Panel using the agreed strategic objectives.

MEETING OF THE PENSION FUND PANEL

6 DECEMBER 2019

REPORT OF THE SERVICE DIRECTOR - FINANCE

7. Training records

Purpose of the report

This report enables the Panel to conduct its annual review of the training records of Pension Fund Panel members and key officers.

Recommendation

The Panel is requested to review the training records attached as Appendices 6 and 7 to this report and assess the adequacy of knowledge and skills acquired by Panel members to fulfil Panel duties.

Key issues

- 7.1 NCCPF's formal Training Policy applies to:
 - Pension Fund Panel members;
 - Local Pension Board Members; and
 - the supporting officers involved in the administration of the LGPS.Adopting a formal policy of this type is intended to **demonstrate** compliance with the spirit of the guidance from the Pensions Regulator (tPR) and CIPFA.
- 7.2 An individual training log showing training undertaken by each of the Panel and Board members as well as key officers was first brought to the May 2015 Panel meeting for review. Training records for Panel members and officers are reported to the Panel and reviewed on an annual basis. Training records for Board members are reported to and reviewed by the Board on an annual basis.
- 7.3 A formal Training Needs Analysis (TNA) procedure was introduced for Panel and Board members in September 2017. Following its introduction, responsibility for assessing the knowledge and understanding acquired individually by **Board** members was assumed by the Board itself.
- 7.4 In order to assess the adequacy of the knowledge and understanding acquired using current practices, the training records for **Panel** members are shown in **Appendix 6**, attached to this report for members' review. For information, the training records for the key officers are shown in **Appendix 7**, attached to this report.
- 7.5 Panel members are asked to review the training records for Panel members:
 - to confirm completeness; and
 - to assess the evidence of adequacy for ensuring that Panel members, *collectively*, have sufficient knowledge and understanding to fulfil the Panel's duties.

MEETING OF THE PENSION FUND PANEL

6 DECEMBER 2019

REPORT OF THE SERVICE DIRECTOR - FINANCE

8. Training needs analysis

Purpose of the report

This report informs Panel members of the requirement to complete a formal training needs analysis annually, and encloses a questionnaire for use in this process.

Recommendation

The Panel is requested to accept the report, and each member of the Panel and Board is asked to complete the questionnaire, enclosed with the report.

Key issues

- 8.1 NCCPF adopted a formal Training Policy in 2015 which was last updated in February 2019. This Policy applies to Panel and Local Pension Board members, as well as senior officers involved in the management of the Fund and administration of the LGPS. The Policy aims to comply with CIPFA's Knowledge and Skills Framework, and states that a training needs analysis procedure was introduced in 2017.
- 8.2 At its 4 September 2017 meeting, the Panel noted the introduction of a formal training needs analysis procedure, which also allowed NCCPF to positively respond to self-assessment criteria included within its 'opt up' to elective professional status under the Markets in Financial Instruments Directive II (MiFID II). All Panel members have responded to first training needs analysis questionnaires issued, and the results have been reported to a subsequent Panel meeting.
- 8.3 Each Panel and Board member is asked to complete the **enclosed** annual training needs analysis questionnaire and return it to Craig Johnson by 20 December 2019. The results will be analysed and taken into account when developing the Fund's Training Plan.

MEETING OF THE PENSION FUND PANEL

6 DECEMBER 2019

REPORT OF THE SERVICE DIRECTOR - FINANCE

9. Review of MiFID II documentation and status

Purpose of the report

This report confirms that there are no changes to NCCPF's circumstances which could affect the professional client status opt ups (under MiFID II) that have already been confirmed to NCCPF by financial institutions.

Recommendation

The Panel is requested to accept the report

Key issues

- 9.1 With effect from 3 January 2018, under Markets in Financial Instruments Directive (MiFID II) LGPS administering authorities were automatically classed as "**retail**" clients unless they had been successfully opted up to "**elective professional**" status by the relevant financial institution.
- 9.2 If classed as a retail client by its fund managers, NCCPF would not have had access to the full range of investments required to implement its investment strategy, as set out in its Investment Strategy Statement.
- 9.3 Late in 2017, NCCPF formally applied to be opted up to elective professional client status by its existing fund managers, custodian and investment advisers. NCCPF provided information for opt up, in a standard template developed by the LGPS Advisory Board. Professional client status is achieved for each financial institution only when it provides the formal confirmation.
- 9.4 On 23 February 2018, it was reported to the Panel that all necessary opt up confirmations from NCCPF investment managers and other financial service providers had been received before 3 January 2018.
- 9.5 Officers now maintain a **MiFID II status update record** showing each financial institution that classes NCCPF as an elective professional client. This includes *all* financial institutions providing relevant services to NCCPF, and others that do **not** provide services but have requested NCCPF's opt up so they can provide product information that is only available to prospective professional clients.
- 9.6 Authorities are **not** required to renew elections on a regular basis but are required to review the information provided and notify the relevant financial institutions of **any changes** in circumstances which **could affect their status**.
- 9.7 A review of the MiFID II application documentation was undertaken in November 2019 and updated in readiness for any future opt up applications. This review confirmed that there are **no notifiable changes** that NCCPF should inform the relevant financial institutions about.

MEETING OF THE PENSION FUND PANEL

6 DECEMBER 2019

REPORT OF THE SERVICE DIRECTOR - FINANCE

10. Outcomes of the October 2019 meeting of the NCC LGPS Local Pension Board

Purpose of the report

This report provides information to the Panel about outcomes and proposals from the meeting of NCC's LGPS Local Pension Board ("the Board") held on 18 October 2019.

Recommendation

The Panel is requested to accept the report.

Key issues

- 10.1 Under the NCC LGPS Local Pension Board's Terms of Reference, the Board is required to meet at least twice a year, and current practice is to meet four times a year. As set out in the remit of the Pension Fund Panel, the Panel's functions include ensuring the proper administration of the Local Government Pension Scheme and the Board "*provides oversight of the governance and administration of the LGPS.*"
- 10.2 From its first meeting in July 2015, the Board has made recommendations to the Scheme Manager (i.e. Northumberland County Council as administering authority for the LGPS) for changes to the LGPS administration and governance arrangements. Since September 2017, Board proposals and outcomes from each meeting have been formally reported to the next quarterly Panel meeting via a Report of the Board Chair, to ensure all relevant Board outcomes are captured and considered by the Panel as a separate agenda item.
- 10.3 The most recent Board meeting was held on 18 October 2019 and the Report of the Board Chair from that meeting is attached as **Appendix 8**.
- 10.4 Topics covered by the Board at that meeting included:
 - 2018/19 Annual Benefit Statements and Pensions Savings Statements;
 - recorded breaches and KPIs;
 - risk register including merger project risk register;
 - results of the Pensions Regulator's cohort review published in September 2019; and
 - review of 31 March 2019 actuarial valuation process.
- 10.5 Gerard Moore, independent Chair of the Board, will present the October 2019 Board meeting outcomes and proposals to the Panel at this meeting.

MEETING OF THE PENSION FUND PANEL

6 DECEMBER 2019

REPORT OF THE SERVICE DIRECTOR - FINANCE

11. Recording breaches and data processing: quarterly monitoring

Purpose of the report

This report provides information about breaches of the law and quarterly monitoring of data processing in and before the quarter to 30 September 2019.

Recommendation

The Panel is requested to note the information in this report and delegate to the NCC LGPS Local Pension Board to review this information in detail at its meeting on 13 December 2019, and report back to the Panel.

Key issues

- 11.1 Oversight of the LGPS by the Pensions Regulator (tPR) from 1 April 2015 brought with it the requirement for administering authorities to demonstrate their commitment to data maintenance and improvement, and to record and (potentially) report breaches of the law to tPR.
- 11.2 Following implementation of the shared administration service with Tyne and Wear Pension Fund (TWPF) in January 2018, information about breaches within the **member administration services** function is reported to NCCPF by South Tyneside Council (STC), and breaches within the functions retained by NCC, including collection of contributions, are reported by NCC officers.

Breaches within functions retained by NCC

- 11.3 In the quarter to 30 September 2019, no employers breached the requirement to pay contributions due to NCCPF within 19 (or 22) days of the end of month in which they were deducted.

Breaches within member administration services

- 11.4 Breaches information within member administration services for the quarter and year to September 2019 is included in the **enclosed “NCC Pension Fund process details”** (on A3 paper). Officers of TWPF and NCCPF are working to develop performance and breaches recording information for both funds. The enclosed is the equivalent of the KPIs which were provided to the Panel prior to implementation of the shared service, but much enhanced in that it covers all administration processes, rather than just five of them. The Board received information at its October meeting that 62 annual benefits statements had not been issued on time. Details of the resulting breach are shown in **Appendix 9**.
- 11.5 This report proposes that the Board be requested to review the attached and enclosed information in detail at its next meeting on 13 December 2019.

MEETING OF THE PENSION FUND PANEL

6 DECEMBER 2019

REPORT OF THE SERVICE DIRECTOR - FINANCE

12. Tyne and Wear Pension Fund's quarterly regulatory report

Purpose of the report

This report provides Tyne and Wear Pension Fund's most recent quarterly regulatory report, which is prepared for the Panel and South Tyneside Council's Pensions Committee to keep members up to date with relevant LGPS regulatory changes.

Recommendation

The Panel is requested to accept the report.

Key issues

12.1 Tyne and Wear Pension Fund (TWPF) takes a report ("the regulatory report"), each quarter, to update its Pensions Committee on relevant LGPS regulatory changes and other related matters. The regulatory report is also brought to the Panel, and attached as **Appendix 10** to this report.

12.2 Items of particular note in the regulatory report:

- | | |
|---------------------------------|--|
| Appendix 10
26 November 2019 | <ul style="list-style-type: none">• MHCLG's consultation on changes to the local valuation cycle• Update on HMT's Guaranteed Minimum Pension (GMP) consultation• The LGPS Advisory Board's (SAB) Good Governance Review• Updates on the SAB's ongoing reviews of academies in the LGPS and "tier 3" employers• Update on public sector Exit Payment Reforms (the £95,000 cap)• Updates on the cost cap mechanism and the McCloud judgement• Update on MHCLG's consultation on Fair Deal• CMA review of Investment Consulting and Fiduciary Management• TPR's cohort review |
|---------------------------------|--|

12.3 All of the items noted in 12.2 above are covered elsewhere on these papers or have been covered in previous reports. In some case, the information contained in Appendix 10 is not as up to date as in these papers, for example report 3 on the Good Governance Review describes Phase II of the Review, whereas Appendix 10 was finalised before Phase II was published.

LGPS Advisory Board's July 2019 meeting summary

12.4 SAB has recently implemented an improvement to communications with LGPS administering authorities by distributing a brief summary of the most recent meeting of the SAB. The most recent summary, for the Board meeting held on 6 November 2019, is attached as **Appendix 11**.

MEETING OF THE PENSION FUND PANEL

6 DECEMBER 2019

REPORT OF THE SERVICE DIRECTOR - FINANCE

13. Fund performance and total Fund value

Purpose of the report

The purpose of this report is to provide information to the Panel about NCCPF's performance in the quarter to 30 September 2019 and the total Fund value at that date.

Recommendation

The Panel is requested to accept the report.

Key issues

- 13.1 The total Fund value (externally managed) was £1,512 million as at 30 September 2019, compared to £1,474 million as at 30 June 2019, reflecting the positive investment returns over the quarter.
- 13.2 Performance for the Fund as a whole was 3.0% for the quarter and 7.6% for the year to 30 September 2019. At the time of finalising this report, the Fund's benchmark returns (for the Fund as a whole) for the quarter and the year had not yet been confirmed due to an anomaly noted in Portfolio Evaluation's total benchmark construction. Therefore, a verbal update will be provided at the meeting.
- 13.3 NCCPF's overweight position in UK index-linked gilts has been a positive contribution to quarterly and annual performance.
- 13.4 Further detail of annual and quarterly performance by manager and asset class for the period ending 30 September 2019 (i.e. the "**Quarterly Risk and Return Analysis**" provided by Portfolio Evaluation Ltd, the Fund's performance measurement service provider) will be **tabled** at the meeting.

13. Fund performance and total Fund value

BACKGROUND

Total Fund value

13.5 The total value of the Fund at the last four quarter ends is as follows:

	as at 31 December 2018 £m	as at 31 March 2019 £m	as at 30 June 2019 £m	as at 30 September 2019 £m
Legal and General <i>Index tracker</i>	1,056.37	1,139.10	1,182.48	1,220.80
Wellington <i>Active corporate bonds</i>	102.85	106.41	109.18	110.14
Schroder	28.95	28.84	28.81	28.38
BlackRock	27.39	27.19	27.00	26.78
Property subtotal	56.34	56.03	55.81	55.16
Morgan Stanley	20.14	20.14	16.83	15.95
NB Crossroads	21.40	21.41	22.48	24.04
Pantheon	8.46	9.80	10.04	9.96
Private equity subtotal	50.00	51.35	49.35	49.95
GIP	38.94	41.16	39.72	40.74
Antin	24.30	24.30	27.55	24.65
Pantheon	-	9.23	9.42	10.93
Infrastructure subtotal	63.24	74.69	76.69	76.32
Total	1,328.80	1,427.58	1,473.51	1,512.37

Note that capital calls and capital repayments have been made during the year to 30 September 2019 for private equity and infrastructure investments. Extra funding, when needed, came out of cash held by the Pension Fund for the day-to-day expenditure incurred in administering the Scheme. Capital repayments have been transferred to Legal and General to invest, or when timing can be matched, used to pay other capital calls.

- 13.6 Further detail of annual and quarterly performance by manager and asset class for the period ending 30 September 2019 (i.e. the “*Quarterly Risk and Return Analysis*” provided by Portfolio Evaluation Ltd, the Fund’s performance measurement service provider) will be **tabled** at the meeting.

Fund performance

- 13.7 The Fund’s performance is measured by Portfolio Evaluation Ltd (formerly, until 31 March 2016 by the WM Company, later known as State Street/GS Performance Services). Shown below are the annual returns achieved by the Fund for the five years to 31 March 2019 and for the latest four quarters. Also shown are the annualised returns achieved by the Fund for the five years to 31 March 2019.

13.8 Annual returns

	Financial year to 31 March				
	2015 %	2016 %	2017 %	2018 %	2019 %
Fund	13.2	-0.7	24.2	3.4	6.9
Benchmark	13.1	-1.2	24.1	3.3	6.2

13.9 Quarterly returns

	--- 2018/19 ---		--- 2019/20 ---	
	Quarter 4 2018 to 31 Dec 2018 %	Quarter 1 2019 to 31 Mar 2019 %	Quarter 2 2019 to 30 Jun 2019 %	Quarter 3 2019 to 30 Sep 2019 %
			Fund	Benchmark
Fund	-5.9	7.2	3.5	3.0
Benchmark	-5.9	7.3	3.6	n/a

13.10 Annualised returns

	All Financial Years Ended 31 March		
	2014/19 %	2016/19 %	2019 %
Fund	9.1	11.2	6.9
Benchmark	8.8	10.8	6.2
	5 years	3 years	1 year

13.11 Asset allocation

	Previous target allocation	Quarter 2 2019 at 30 Jun 2019		Quarter 3 2019 at 30 Sep 2019		Current target allocation*
		%	£m	%	£m	
Equities						
UK	24.0	360.5	24.5	189.9	12.5	12.0
US	7.0	109.0	7.4	150.5	10.0	9.6
Europe	7.0	109.5	7.4	141.9	9.4	9.0
Japan	3.5	51.1	3.5	111.4	7.4	7.2
Asia Pacific ex Japan	3.5	54.0	3.7	112.6	7.4	7.2
Emerging Markets	7.0	106.7	7.2	112.1	7.4	7.2
RAFI 3000	<u>8.0</u>	122.7	<u>8.3</u>	125.0	<u>8.3</u>	<u>7.8</u>
	<u>60.0</u>	<u>62.0</u>		<u>62.4</u>		<u>60.0</u>
Bonds						
Index-linked	15.0	269.0	18.3	277.4	18.3	15.0
Corporate bonds	<u>10.0</u>	109.2	<u>7.4</u>	110.1	<u>7.3</u>	<u>10.0</u>
	<u>25.0</u>		<u>25.7</u>		<u>25.6</u>	<u>25.0</u>
Illiquids						
Property	5.0	55.8	3.8	55.2	3.7	5.0
Private Equity	5.0	49.3	3.3	50.0	3.3	5.0
Infrastructure	<u>5.0</u>	76.7	<u>5.2</u>	76.3	<u>5.0</u>	<u>5.0</u>
	<u>15.0</u>		<u>12.3</u>		<u>12.0</u>	<u>15.0</u>
Cash						
Total	100.0	1,473.5	100.0	1,512.4	100.0	100.0

* allocation with effect from 1 October 2019.

13.12 The amounts shown above, as at 30 September 2019, are **after** the final transaction took place to implement the new target asset allocation for NCCPF, as set by the Panel at its meeting on 12 July 2019.

13.13 The Fund remains overweight in long-dated index-linked gilts with 18.3% of Fund value invested at 30 September 2019, against a target weight of 15.0%. Investment returns on these bonds were:

- 8.7% in the quarter ended 30 September 2019;
- 10.9% in the year ended 30 September 2019; and
- 5.4% (annualised) in the three years ending 30 September 2019.

13.14 Therefore, the Fund's overweight position in index-linked gilts has made a positive contribution to performance in the quarter.

IMPLICATIONS ARISING OUT OF THE REPORT

This applies to items 1. to 13. (inclusive) in this report

Policy:	None
Finance and value for money:	All investment decisions and funding strategy decisions could have an implication for the future employer contribution rates payable by employers participating in the Pension Fund. There are no investment decisions arising directly from these reports.
Human Resources:	None
Property:	None
Equalities:	None
Risk Assessment:	A risk assessment is performed as part of the asset liability modelling study undertaken periodically (usually every three years) to set the Fund's asset allocation strategy. There is no change to investment strategy contained within these reports.
Sustainability:	None
Crime & Disorder:	None
Customer considerations:	None
Consultation:	None
Electoral divisions:	All

Report sign off

Finance Officer	N/A
Monitoring Officer/Legal	N/A
Human Resources	N/A
Procurement	N/A
I.T.	N/A
Service Director - Finance	AE
Portfolio Holder(s)	N/A

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